No. 12498.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, as receiver of the Estate of SALSBURY MOTORS, INC., Debtor,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION,

Appellee.

APPELLANT'S OPENING BRIEF.

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APPELLANT'S OPENING BRIEF.

To the Honorable Judges of the United States Court of Appeals, for the Ninth Circuit:

This appeal is from a final order of the District Court for the Southern District of California, Central Division, the Honorable Harry C. Westover, Judge presiding [Tr. 150-152]. The order was made in a proceeding under Chapter XI of the Bankruptcy Act and was an affirmation of the order of the Referee in Bankruptcy and a denial of the appellant's petition for review thereof. The said order constituted a ruling that the petition of appellant-receiver to subordinate the claims of the Bank of America presented controversies and issues beyond the jurisdiction of the Bankruptcy Court and that the appellant had failed to state a claim upon which any relief could be granted.

Jurisdictional Statement.

As a court of bankruptcy, the United States District Court had jurisdiction of this cause pursuant to the Act of July 1, 1898, as amended.[1] On August 20, 1947, the debtor (hereinafter referred to as "Salsbury") filed a petition under Chapter XI of the Bankruptcy Act and thereby commenced this bankruptcy proceeding [Tr. 2-18]. On the same day, the petition was approved by the Honorable Leon R. Yankwich, Judge of the United States District Court, and the matter was referred to Hugh L. Dickson, referee of said court [Tr. 19]. On September 9, 1947, appellee, Bank of America National Trust & Savings Association (hereinafter referred to as "Bank" or "Bank of America") filed a proof of partially secured debt [Tr. 124-147].[2] On July 30, 1948, the appellant-receiver filed a petition for order subordinating claims of Bank of America [Tr. 58] with a supplement thereto being filed by the receiver on January 21, 1949 [Tr. 63]. On July 30, 1948, the referee in bankruptcy issued an order to show cause on the receiver's petition, directing the Bank to appear and show cause why the relief requested in the petition should not be granted [Tr. 67]. At the hearing on the order to show cause, the Bank filed its

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[1]Chapter 541, Sections 1 and 2, 30 Stat. 544, 545, as amended; United States Code, Title XI, Chapter 1, Section 1, Chapter 2, Section 11.

[2]The filing date shown on page 147 of the printed transcript of record herein is in error; the correct date is September 9, 1947.

response to the receiver's petition [Tr. 79] objecting to the jurisdiction of the Bankruptcy Court and to the sufficiency of the petition and the supplement thereto as stating a claim upon which relief could be granted. By order dated March 19, 1949, the Referee dismissed the order to show cause and denied the petition on the ground that the Bankruptcy Court was without jurisdiction to hear and determine the matter [Tr. 83]. A petition to review said order was duly filed by the receiver [Tr. 107], and by order dated January 6, 1950, and entered January 20, 1950, the Honorable Harry C. Westover denied the appellant's petition for review [Tr. 150]. Within the time allowed by law, appellant filed a notice of appeal [Tr. 152] and said appeal has been perfected by taking all the steps required by law.

The jurisdiction of the Court of Appeals is invoked pursuant to Sections 24 and 25 of the Bankruptcy Act.[3] Appellate jurisdiction over this proceeding in bankruptcy vested in the Court of Appeals upon the receiver's filing his notice of appeal on February 3, 1950; the amount involved is in excess of $500.00.

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[3]Act of July 1, 1898, as amended, Chapter 541, Sections 24 and 25; 30 Stat. 533, as amended; United States Code, Title XI, Chapter 4, Sections 47 and 48.

Statement of the Case.

Introductory Statement.

Prior to the confirmation of the plan of arrangement hereinafter mentioned, the Bank of America filed a claim in the Chapter XI proceedings against the debtor in an amount in excess of six hundred thousand dollars, of which the Bank alleged that approximately three hundred eighty thousand dollars was secured, leaving a claimed balance unsecured in the sum of approximately one hundred and twenty-six thousand dollars [Tr. 124-147]. After the said claim was filed, and prior to confirmation of the plan of arrangement, the receiver filed objections to the claim with a prayer for affirmative relief on the ground that the Bank had wrongfully seized certain commercial paper belonging to the debtor under an alleged claim of banker's lien. The Referee overruled the said objection to the claim, and the Referee's ruling was affirmed by the District Court on review; that controversy is now pending before this Honorable Court.[4]

The instant proceedings, which are involved in this appeal, are separate and distinct from the aforesaid objections to the claim. These proceedings were commenced with the receiver's petition and supplement thereto [Tr. 58-66] alleging in substance that the Bank had knowingly given false and misleading information to the existing unpaid creditors of the debtor herein pertaining to the

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[4]*Goggin v. Bank of America National Trust & Savings Association* (United States Court of Appeals for the Ninth Circuit No. 12206).

Opinion affirming order appealed from filed February 23, 1950; petition for rehearing filed March 24, 1950; rehearing granted April 18, 1950, and cause now stands submitted.

financial condition of the debtor, intending the reliance thereon by creditors, and that on the basis of this misinformation those persons who are now the unpaid creditors of the debtor extended credit to the debtor, which credit would not have been extended had the Bank given a true statement of the facts it then knew relating to the debtor's position. By reason of these facts, the receiver alleged that it would be unfair and inequitable to permit the Bank to participate in the distribution of dividends on a parity with those persons who had relied upon, and had been misled by the misinformation given them by the Bank.

A separate aspect of the subordination petition and supplement thereto pertains to the sum of $75,000.00 paid to the receiver by Northrop Aircraft, Inc., a corporation, which was the parent owning all of the capital stock of the debtor in this proceeding. Northrop Aircraft, Inc., had filed a claim against the debtor for a sum in excess of one million dollars, and the receiver had filed objections thereto with a prayer for affirmative relief on the ground that Northrop was the *alter ego* of the debtor and was therefore liable for all of the debtor's indebtedness. The controversy between Northrop Aircraft, Inc., and the receiver was compromised and settled in consideration of Northrop's paying to the estate the sum of $75,000.00 and agreeing to subordinate its entire claim against the debtor to the claims of all of the other creditors. The payment of said $75,000.00 to the receiver was expressly agreed to be based upon the *alter ego* contentions of the receiver against Northrop Aircraft, Inc. [Tr. 49-52]. In the receiver's petition in the instant case, he alleged that the $75,000.00 payment in compromise of his *alter ego* contentions against Northrop Aircraft, Inc., could not

equitably be the basis for the payment of any dividends to the Bank because the Bank, in extending credit to the debtor herein, was the only one of all the unpaid creditors that had been specifically informed by Northrop that Northrop would not be responsible for the obligations of the debtor, and that by reason of this fact the Bank had insisted that Northrop agree to subordinate payment of all of its claims against the debtor until the claim of the Bank was paid. On the basis of these allegations, the receiver, in addition to praying for the subordination of the entire claim of the Bank of America as hereinabove described, concluded with a prayer that if the Court did not grant the complete subordination prayed for, the Bank of America should not, for the reasons stated, participate in any dividends from the $75,000.00 paid into the estate by Northrop Aircraft, Inc.

On the day of the hearing of the receiver's petition and supplement thereto (almost 8 months after the original order to show cause was issued), the Bank served and filed a document entitled "Response to Order to Show Cause re Petition of Receiver for Order Subordinating Claims of Bank of America National Trust & Savings Association" [Tr. 79]. Although four separate grounds of objection were asserted in the said response, the substance thereof was that the Court had no jurisdiction to entertain the receiver's petition, and that, in any event, the receiver's petition failed to state facts entitling him to any relief. The Referee orally indicated that his ruling in favor of the Bank would be limited to the ground

that the Court had no jurisdiction because he construed the order confirming the plan of arrangement as reserving no such jurisdiction [Tr. 160]. The formal written order [Tr. 83], despite the receiver's objections thereto [Tr. 86], provided that all of the objections set forth in the aforesaid response of the Bank were well founded. A similar type of order was entered by the District Judge on review from the Referee's order [Tr. 115, 148]. It is significant to note that the debtor's proposed second amended plan of arrangement [Tr. 39], which was subsequently confirmed by the Court, was filed with the Court on July 8, 1948, and the order confirming the plan of arrangement [Tr. 40-44] was entered July 30, 1948, the same day on which the original petition of the receiver for an order subordinating the claims of the Bank of America was filed [Tr. 58-62].

Our basic contentions are:

1. The Bankruptcy Court had jurisdiction to hear and determine the matters set forth in the receiver's petition and supplement thereto and his amended petition.

2. The receiver's petition and supplement thereto stated a claim upon which relief could be granted.

3. There was an abuse of the discretion of the Referee and District Judge in their failure to consider the receiver's amended petition, which stated a cause of action.

Detailed Statement.

The summary of debts and assets filed by the debtor herein [Tr. 16-18] showed a total indebtedness of $2,724,881.00, and total assets of $2,162,957.17. Included within the scheduled obligations of the debtor was an obligation of an amount in excess of $1,345,000.00 allegedly owing to Northrop Aircraft, Inc., which corporation was the parent of the debtor, its wholly owned subsidiary [Tr. 49]. By operation of a compromise between Northrop Aircraft, Inc., and the receiver, Northrop's claim was subordinated to the claims of all other creditors [Tr. 50-51]. The Bank asserted a claim against the debtor alleging that as of the date of the commencement of the bankruptcy proceedings the debtor was indebted to the Bank in a sum slightly in excess of $601,000.00; the Bank further set forth in its proof of claim that it held, under an asserted banker's lien, approximately $175,000.00 worth of notes, drafts and merchandise, the proceeds of which would be credited against the indebtedness when received. The proof of claim of the Bank asserted that a portion of the inedbtedness was secured by a deed of trust that had originally been given to secure a promissory note of the debtor in the principal amount of $180,000.00, but which deed of trust contained a provision that it was to be security for any and all other indebtedness and obligations of the debtor to the Bank, whether present or future [Tr. 124-148]. In its proof of claim the Bank estimated the value of the security to be $300,000.00.

It will thus be seen that, after eliminating the alleged indebtedness to the parent corporation, the total indebted-

ness to the Bank constituted approximately 50% of the total indebtedness of the debtor.

The debtor's proposed second amended plan of arrangement was filed with the Referee in Bankruptcy on July 7, 1948 [Tr. 29-39], and was confirmed by an order of the Referee on July 30, 1948 [Tr. 40-57]. The second amended plan of arrangement, prior to its confirmation by the Court, was submitted to the debtor's creditors, who duly filed their written consents thereto. One of these consents is included in the record on appeal [Tr. 56]. The consent recited that the "undersigned has received a copy of the debtor's second amended plan of arrangement and does hereby consent to . . . the provisions and terms thereof, and agrees that the above entitled court may enter an order confirming the same." The consent closed with the following proviso:

> "This consent to the second amended plan of arrangement, except in respect to the release of the debtor and Northrop Aircraft, Inc., and the approval and confirmation by the court, shall not in any manner prejudice the rights, defenses or cause of action that the undersigned, as a creditor, would have, or that George T. Goggin, as receiver, now has, or that George T. Goggin, as trustee in bankruptcy, would have, or any creditor of Salsbury Motors, Inc., would have, in the event that Salsbury Motors, Inc., were adjudged a bankrupt and George T. Goggin were duly appointed trustee in bankruptcy, but that the rights of the undersigned and all parties shall be the same as if Salsbury Motors, Inc., were so adjudged a bankrupt and George T. Goggin were appointed trustee." [Tr. 57.]

Thus the consents of the creditors were based upon the provisions of the plan, and, therefore, in connection with the issue here presented as to the reservation of jurisdiction by the Bankruptcy Court, it is necessary to look at the plan itself [Tr. 45-56]. Article I of the plan [Tr. 45] provides that the creditors of the debtor be divided into four classes, the first class being those debts which were expenses of administration incurred in the Chapter XI proceedings; the second class covered the debits entitled to priority under the Bankruptcy Act; the third class was composed of all creditors holding securities or liens; and the fourth class was "all other creditors" who, it was provided, were to be paid:

> ". . . a pro rata dividend in the same manner and with like effect as if an order of adjudication were entered herein, and the trustee in bankruptcy was paying a partial or final dividend, said payments to be made at such time and in such amounts as the court may from time to time upon the petition of any party in interest, order, and the court to reserve jurisdiction to determine the amount and validity of all claims and the classification of said claims and all objections that may be made in respect thereto with like effect and power as if the above-named debtor had been adjudicated a bankrupt, and George T. Goggin was the acting trustee in bankruptcy. That said George T. Goggin, as receiver and disbursing agent, shall have the right to object to any and all claims with like effect as if he were acting in the capacity of trustee in bankruptcy." [Tr. 46.]

Article IV of the plan sets forth the authorization and powers and duties of the receiver, and the reserved jurisdiction of the Court in the following all-inclusive language:

> "That there remain vested in George T. Goggin as receiver and disbursing agent, all causes of action, exclusive of the matters settled and compromised as set forth in Article V herein, that could or would vest in George T. Goggin as trustee in bankruptcy in the event an order of adjudication were entered in the above-entitled proceeding, with full right and power to prosecute any and all causes of action, objections to claims, with full right to assert all offsets, counterclaims and affirmative claims, and any and all other rights that are now vested in him as receiver herein or that would vest in him as a trustee in bankruptcy in the event of the entry of an order adjudging the above-named debtor to be a bankrupt under the Acts of Congress relating to bankruptcy, and the appointment of George T. Goggin as trustee in bankruptcy. There shall remain vested in the creditors, such rights of actions and claims as they may have at this time against parties other than the debtor, exclusive of the matters settled and compromised in Article V herein, without limiting any of the foregoing provisions contained in this Article, the order confirming the second amended plan of arrangement and the acceptance by creditors of the same, shall be without prejudice as to the rights of creditors, receiver, his successor in interest, or the bankrupt estate, in connection with any and all proceedings or claims existing or now pending or that may be instituted against any person or corporation, except the rights, claims and demands settled and compromised under Article V herein." [Tr. 48-49.]

Article V of the plan sets forth the complete disposition with respect to the claim of Northrop Aircraft, Inc. There is an express recognition in that article of the position which was to be taken by the receiver with respect to subordination of the claim of the Bank of America. In the portion of that article whereby Northrop Aircraft, Inc., agreed to indemnify the receiver in the approximate sum of $90,000.00 against any liability to the Bank of America by reason of the Bank's assertion of rights to receive dividends on Northrop's claim, it is expressly stated:

> ". . . The indemnity liability of Northrop shall not be increased by reason of any increase in the claim of the Bank of America as above set forth, or by reason of any subordination of such claim of the Bank of America, in whole or in part, to the claims of other general creditors with respect to the funds in the hands of George T. Goggin, as receiver, or any part thereof, or as a result of any other litigation, controversy or settlement between said George T. Goggin and said Bank of America, which affect the status or the amount of said claim." [Tr. 51-52.]

Again, in Article VI of the plan [Tr. 52] there is a reiteration of the retention of jurisdiction by the Court in the following language:

> "The court to retain jurisdiction to carry out the plan of arrangement and to pass upon all controversies with creditors and third parties, with like effect as if an order of adjudication were entered herein and George T. Goggin was appointed trustee in bankruptcy."

After notice duly given to creditors, upon a hearing on the debtor's petition to confirm the second amended plan of arrangement, the Referee in Bankruptcy issued his order confirming the second amended plan of arrangement [Tr. 30-44], which contained the following language:

> "It is Hereby Ordered, Adjudged and Decreed that said Arrangement, a copy of which is annexed hereto and marked Exhibit 'A', be and it hereby is confirmed. . . ." [Tr. 41.]

The order further provided:

> "It Is Further Ordered that this court retains and reserves jurisdiction to determine the amount and validity of all claims of creditors, both secured and unsecured, and the classification of said claims, and all objections that have heretofore been made or that may be made in regard thereto, with a like effect and power as if the above-named debtor had been adjudged a bankrupt and George T. Goggin were the acting trustee in bankruptcy; and that George T. Goggin, as receiver and disbursing agent, shall have the right to object to any and all claims with like effect as if he were acting in the capacity of a trustee in bankruptcy." [Tr. 43.]

The order confirming the plan contained the required findings that written consents of creditors had been filed with the Court by creditors having provable claims in excess of a majority in number and amount of the total claims, that the arrangement was for the best interests of

the creditors, and that it was fair and equitable [Tr. 40-41].

On the same date that the order confirming the plan was entered, the receiver filed his verified petition for an order subordinating the claim of the Bank of America [Tr. 58-62]. On the same date, the Referee in Bankruptcy issued an order to show cause directing the Bank to appear and show cause why the prayer of the petition should not be granted [Tr. 67]. Thereafter, the receiver filed his supplement to the petition setting forth additional allegations in support of the subordination requested [Tr. 63-66].

It is significant that the order confirming the plan of arrangement contained the Bank's written approval as to form [Tr. 44]. Another positive indication contained in this record that the Bank had actual knowledge that the receiver was attempting to subordinate the Bank's claim to the claims of all other creditors, is contained in the agreement of indemnity given to the receiver by Northrop Aircraft, Inc., which was approved by the Referee in Bankruptcy [Tr. 68-72]: the form of the indemnity agreement also was approved by counsel for the Bank of America [Tr. 71]. It was provided therein that the liability of the indemnitor should not be increased "by reason of any subordination of such claim of the Bank in whole or in part to the claims of other general creditors with respect to the funds in the hands of George T. Goggin as receiver or any part thereof or as a result of any other litigation, controversy or settlement between said

George T. Goggin as receiver and the Bank which affects the status or the amount of said claim" [Tr. 69]. In approving the indemnity agreement, the Referee in Bankruptcy stated in his order that "this court retains jurisdiction of the subject matter and parties to the said agreement pending its final performance or discharge . . ." [Tr. 71]. A few months later there was filed in the bankruptcy proceedings a release and satisfaction of indemnity agreement, whereby the Bank acknowledged that Northrop Aircraft, Inc., had paid, or agreed to pay, the Bank "an amount equal to the amount that it would have received if it had received, from the assets in the hands of the receiver at the date of confirmation of the plan, a dividend upon Northrop's claim, at the same rate of dividends paid to creditors generally, to the extent necessary to pay its claim in full" [Tr. 77].[5]

On the date set for hearing on the receiver's petition and the supplement thereto, and the order to show cause issued thereon, the Bank served and filed its response to the order to show cause [Tr. 79] asserting that the Bankruptcy Court was without jurisdiction to hear and determine the matters set forth in the receiver's petition, and that the facts stated therein did not afford a basis for any relief. At the conclusion of the hearing on that date, the Referee orally ruled that the Court was without jurisdic-

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[5]The amount thus paid was estimated by Northrop to be approximately $90,000.00 [Tr. 69].

tion to determine the controversy and stated that his ruling would be limited to that ground [Tr. 158-160].

Thereafter the receiver served and filed a notice of motion to reconsider the aforesaid oral ruling [Tr. 81-83]; a hearing on said motion was held on March 18, 1949 [Tr. 155-157]. At the conclusion of the hearing, the receiver, through his counsel, asked leave to serve and file an amended petition, which request was thereupon denied [Tr. 155-157].

Thereafter, on March 18, 1949, the Bank prepared a form of order and submitted it to the Referee and served a copy upon counsel for the receiver. The said form of order submitted by the Bank went considerably beyond the oral ruling of the Referee in that the said order contained a recital that all of the objections set forth in the aforementioned response of the Bank of America were well founded. The day following receipt of the said form of order, the receiver filed formal objections to the order in which the receiver set forth the aforesaid variance between the form of order and the oral ruling of the Referee as the grounds for his objections [Tr. 86-91]. Also included in said objections was the request that, if the Referee saw fit to sign such an order as that submitted by the Bank, the receiver have leave to file an amended petition; a copy of the proposed amended petition was attached to said objections [Tr. 90-91]. At a hearing on the aforesaid objections of the receiver to the form of order, the Referee indicated that he had already signed

the proposed form of order [Tr. 162].[6] The Referee overruled the receiver's objections to the form of order but did permit the receiver to file his amended petition, expressly stating, however, that the original order would stand and the filing of the amended petition was not to be considered as affecting the original order [Tr. 165-166].

The receiver duly filed and perfected his petition for review of the aforesaid order of the Referee to the District Court [Tr. 107-122]. Upon review, the Honorable Harry C. Westover, United States District Judge, affirmed the ruling of the Referee by an order dated January 6, 1950, and entered January 20, 1950 [Tr. 150]. The form of order used by the District Court was objected to by the receiver for the reason that the order made no mention of the receiver's amended petition; the receiver contended that he was entitled to a ruling as to whether or not the amended petition had been considered by the District Court [Tr. 148-150].

This appeal followed.

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[6]Under Rule 7 of the Rules of the United States District Court for the Southern District of California (effective January 15, 1944, as amended March 2, 1949) it is provided:

> "No document governed by this rule shall be signed by the judge unless opposing counsel shall have endorsed thereon an approval as to form, or shall have failed to file with the judge, within five days from the time of the receipt of a copy thereof, as such time is shown on the original or by affidavit of service, a written detailed statement of the objections thereto and the reasons therefor."

Here there was a failure to comply with this rule.

Specifications of Error.

Appellant contends that the District Court and the Referee erred in the following respects:

1. In holding that the Bankruptcy Court had no jurisdiction to grant the relief sought by the appellant either in his petition and supplement thereto, or in his amended petition to subordinate the claim of the Bank of America.

2. In holding that the receiver did not have the power or authority to file the aforesaid petition for subordination of the claim of the Bank of America.

3. In holding that the aforesaid petition and supplement thereto, and the amended petition failed to state claims upon which the relief therein requested could be granted.

4. In refusing to grant the receiver leave to amend his pleadings, after apparently holding that the original pleadings did not state facts sufficient to constitute a cause of action, such refusal constituting an abuse of discretion.

Summary of Argument.

We do not intend to discuss herein the first ground of objection set forth in the Bank's response filed with the Referee [Tr. 79] to the effect that the Bankruptcy Court had no jurisdiction to entertain the receiver's petition by reason of the pending appeal in this Court involving the propriety of the Bank's attempted exercise of a banker's lien.[7] We do not feel that this objection was seriously

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[7]This matter is now under submission before this Court on rehearing in Case No. 12206.

See footnote 4, *supra.*

urged inasmuch as the distinction between the banker's lien appeal and this appeal is so patently apparent. The banker's lien appeal involved the overruling of the receiver's objections to the Bank's claim in which the receiver contended that the Bank had wrongfully seized certain commercial paper belonging to the debtor under an alleged claim of banker's lien. At all times the receiver has acknowledged that the debtor was indebted to the Bank and has at no time, either in the banker's lien proceeding or in this subordination proceeding, contended that the Bank was not a creditor of the debtor. The substance of the banker's lien litigation was the receiver's counterclaim that the Bank had wrongfully seized and converted certain property belonging to the debtor and had wrongfully credited the value of this property against the Bank's claim. In his objections the receiver prayed that the Bank be required to pay to the receiver the value of the seized property. If the receiver is successful in the banker's lien litigation, the amount of the Bank's claim against the debtor will be increased; therefore, the final result of the banker's lien appeal will liquidate the Bank's claim, which is now in an unliquidated amount.

The present appeal is based upon the premise that the Bank will ultimately have a liquidated claim against the debtor, and the receiver seeks by this proceeding to have the payment of such claim subordinated to the claims of other creditors. In other words, the receiver is seeking to defer any payment of dividends on the Bank's claim until the claims of other creditors have been paid. The fundamental difference between the allowance of the claim as a legal debt of the debtor, and the order of payment of dividends on that claim, has been made abundantly clear by

a consistent line of cases starting with the leading case of *Pepper v. Litton* (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 Am. B. R. (N. S.) 279, in which the Supreme Court stated:

> "Though disallowance of such claims will be ordered where they are fictitious or a sham, these cases do not turn on the existence or non-existence of the debt. Rather they involve simply the question of order of payment."[8]

We contend that the judgment of the lower court should be reversed for the following reasons:

1. The Bankruptcy Court had jurisdiction to order the subordination of the payment of the claim of the Bank to the general unsecured creditors of the debtor by reason of the confirmed plan of arrangement, the order of confirmation, and under its inherent jurisdiction over the distribution of the funds or other assets in its possession.

2. The receiver, both under the plan and under the order confirming it, had the right, power, authority and duty to present the facts set forth in his petition to the Bankruptcy Court, and to invoke the equitable jurisdiction of the Court to defer any payment of dividends to the Bank of America until the claims of all other creditors had been paid.

3. The facts set forth in the petition and supplement thereto, or in the amended petition, if proved, would entitle the receiver to the relief prayed for.

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[8]See also: *Columbia Gas & Electric Corp. v. U. S.* (1941, 6th Cir.), 151 F. 2d 461; rehearing denied, 153 F. 2d 101; *Cert. den.*, 329 U. S. 737. (The Court modified the order of the Bankruptcy Court so as to subordinate the claim, *not* disallow it.)

ARGUMENT.

I.

The Bankruptcy Court Had Jurisdiction to Order the Subordination of the Payment of the Claim of the Bank to the General Unsecured Creditors of the Debtor.

(a) Under the Confirmed Plan of Arrangement.

It is readily apparent from a reading of the plan of arrangement [Tr. 45-56], the form of consents by creditors thereto [Tr. 56-57], and the order confirming the plan of arrangement [Tr. 40-44], that the intention of all the parties was to release to the debtor all of the assets which were being administered by the Bankruptcy Court in the Chapter XI proceedings, free and clear of all liens, claims and debts of creditors, in consideration for which the debtor was to pay to the receiver the sum of $500,000.00 for administration by the Bankruptcy Court, as if said consideration constituted the estate of an adjudicated bankrupt with the receiver having all the rights, powers and duties of a trustee in bankruptcy.

Article I of the plan divided the creditors into classes, of which the fourth class (Class D) was composed of all creditors except those included in the first three classes [Tr. 46]. The Bank's claim falls into Class D. It is expressly provided in the paragraph creating the class, that jurisdiction of the Bankruptcy Court is reserved to determine the amount and validity of all claims *"and the classification of said claims"* with the reservation of jurisdiction being co-extensive with the jurisdiction that the Court would have had, had the debtor been adjudicated a bankrupt with the receiver acting as trustee in bankruptcy [Tr. 45-46].

In Article IV it is again provided that the receiver shall have the same authority as a trustee in bankruptcy would have after an adjudication "with full right and power to prosecute any and all causes of action, objections to claims, with full right to assert all offsets, counterclaims, and affirmative claims, and any and all other rights that are now vested in him as receiver herein or that would vest in him as trustee in bankruptcy in the event of an order adjudging the above named debtor to be a bankrupt" [Tr. 48].

In Article VI there was recognition of the commencement of a subordination proceeding against the Bank by the receiver in providing that the indemnity liability of Northrop Aircraft, Inc. should not be increased "by reason of any subordination of such claim of the Bank of America, in whole or in part, to the claims of other general creditors with respect to the funds in the hands of 'the receiver' or as a result of any other litigation, controversy or settlement between said George T. Goggin and said Bank of America, which affect the status or the amount of said claims" [Tr. 52].

In Article VI the Court retains jurisdiction to pass upon all controversies with creditors and third parties, to like effect as if there had been an adjudication in bankruptcy and George T. Goggin had been appointed trustee in bankruptcy [Tr. 52-53].

Article VII provides for the retention of moneys by the Bankruptcy Court to cover prospective dividends on disputed claims [Tr. 53].

The consents of creditors to the second amended plan of arrangement expressly limit the use of the consents to the terms of the plan. A form of such consent is in-

cluded in the record on this appeal and it clearly appears therefrom that the consenting creditors conditioned their consents upon the terms of the plan itself [Tr. 56-57]. Moreover, the consents of the creditors further provided that the consent "shall not in any manner prejudice the rights, defenses or cause of action that the undersigned, as a creditor, would have, or that George T. Goggin, as receiver, now has, or that George T. Goggin, as trustee in bankruptcy, would have, or any creditor of Salsbury Motors, Inc. would have in the event that Salsbury Motors, Inc. were adjudged a bankrupt and George T. Goggin were duly appointed trustee in bankruptcy. . . ."

There can be no doubt that the plan of arrangement and the consents to the plan reserved jurisdiction in the Bankruptcy Court to determine any controversies with respect to creditors' claims to like effect as if there had been an adjudication in bankruptcy. The appellant's petition to have the claim of the Bank of America subordinated to claims of all other creditors is clearly the type of controversy within the jurisdiction of a Bankruptcy Court where there has been an adjudication in bankruptcy.

Quite apart from the Bankruptcy Court's statutory authority to allow and disallow claims asserted against the bankrupt,[9] it has long been recognized that a Court of Bankruptcy has the power to postpone payment of dividends upon the admittedly valid claim of a creditor to the claims of other creditors of the same class where the former has been guilty of conduct which, under the ordi-

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[9]Sections 2(a)(2), 57(f) and 57(k) of the Bankruptcy Act (11 U. S. C., Secs. 11(a)(2), 93(f) and 93(k).)

nary rules of equity, would make it inequitable for him to share on an equality with other creditors.[10]

The leading case dealing with this salutory principle is *Pepper v. Litton* (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 Am. B. R. (N. S.) 279, in which the Court stated:

> "In the exercise of its equitable jurisdiction, the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate."[11]

The appellee herein, both before the Referee and the District Court below, made the very same contention that it had unsuccessfully urged to this Court in *Bank of America v. Erickson* (1941, 9th Cir.), 117 F. 2d 796, 45

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[10]Two of the earliest cases are: *In re Headley* (1899, D. C., Mo.), 97 Fed. 765, 3 Am. B. R. 272; *In re Royce Dry Goods* (1904, D. C., Mo.), 133 Fed. 100, 13 Am. B. R. 257. See also Annotation (1936): "Power of Bankruptcy Court to Adjudicate Equities Among Creditors in Distribution of Dividends," 100 A. L. R. 660-667.

[11]The Supreme Court succinctly stated the same principle in another case as follows:

> "The power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete. *Taylor v. Standard Gas & Electric Co.,* 306 U. S. 307, 38 Am. B. R. (N. S.) 692; *Pepper v. Litton,* 308 U. S. 295, 41 Am. B. R. (N. S.) 279; *Bird & Son Sales Corp. v. Tobin* (C. C. A., 8th Cir.), 29 Am. B. R. (N. S.) 171, 78 F. (2d) 371." *Sampsell v. Imperial Paper & Color Corp.* (1941), 313 U. S. 215, at 219, 45 Am. B. R. (N. S.) 454.

For a thorough discussion of the principle, see *In the Matter of Kansas City Journal-Post Company* (1944, 8th Cir.), 144 F. 2d 791, 57 Am. B. R. (N. S.) 47.

Am. B. R. (N. S.) 503. This Court stated the contention and its disposition thereof in the following language:

> "Appellant contends, in the first place, that a justiciable controversy growing out of the agreement to subordinate exists between it and the other creditors; that the bankruptcy court is without jurisdiction to determine the dispute; that the McComb and Hickerson claims should be allowed without prejudice and the creditors relegated to another forum for the adjudication of the controversy.
>
> The argument finds little support in the authorities. The bankruptcy court has undoubted power to subordinate a general claim to other claims in the same category where for any reason, legal or equitable, it ought to be subordinated."

In holding that the claims of stockholders of a bankrupt corporation should be subordinated to claims of the general unsecured creditors, the Court of Appeals for the 2nd Circuit referred to the recent line of cases of the Supreme Court, from which it deduced the following test:

> "The test does 'not turn on the existence or nonexistence of the debt' nor on the existence of an 'instrumentality' or the like; the test is whether the failure to subordinate will 'work injustice', will not 'be fair and equitable to other creditors', will result 'in the violation of rules of fair play and good conscience'."[12]

In the instant case, however, this Court does not have the benefit of any findings by the lower court with respect to this test for the reason that the ruling was made without the taking of any evidence because the Referee and the District Court were of the opinion that the Court was

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[12] *In re Loewer's Gambrinus Brewery Co.* (1948), 167 F. 2d 318, at 319.

without jurisdiction to grant the relief requested by the receiver. The receiver is now before this Court seeking a reversal so that he may have an opportunity to prove the allegations of his petition and the supplement thereto, and the amended petition, in order that there can be a determination made as to whether the failure to subordinate the Bank's claim will work injustice on the other creditors of the debtor.

(b) Under the Order of Confirmation.

We have already set forth herein the provisions of the order confirming the plan of arrangement dealing with the reservation of jurisdiction by the Bankruptcy Court. That reservation of jurisdiction is wholly inconsistent with the ruling of the District Court and the Referee that no jurisdiction was reserved to consider a controversy such as that presented by the receiver's petition to subordinate the claim of the Bank of America. The order confirming the plan [Tr. 40-44] expressly referred to the plan of arrangement and annexed a copy thereto as Exhibit "A", thereby making the plan itself a part of the order confirming it [Tr. 41]. Accordingly, all of the arguments set forth in subsection (a) of this brief are equally applicable to the order confirming the plan. The reference to the plan would of itself have been sufficient to answer the objection made by the Bank to the jurisdiction of the Court, but the order contained additional language expressly reserving jurisdiction "to determine . . . the classification of said claims . . . with a like effect and power as if the above named debtor had been adjudged a bankrupt" [Tr. 43]. *How could there be a plainer and more explicit reservation of jurisdiction than that contained in this language of the order?*

The Bank of America took the position before the Referee and the District Court that the measure of the jurisdiction retained by the Bankruptcy Court upon confirmation of a plan of arrangement was the order of confirmation, which the Bank contended must be considered separate and apart from the plan in the event of any variance between the two. While we contend that there is no such variance in this case, if there were any such conflict, it must be resolved in favor of the plan. The reason for this is, of course, that the plan of arrangement upon confirmation becomes a contract between the debtor and all of the creditors which vests certain rights and corresponding duties in the respective parties which the Bankruptcy Court has no power to modify. "In a composition the rights of each creditor are fixed by the terms of the bankrupt's offer, subject only to its confirmation and the judge's order of distribution."[13]

Judge Learned Hand, speaking for the 2nd Circuit, in the case of *Equitable Holding Corp. v. Woody* (1933), 63 F. 2d 751 at 753, 23 A. B. R. (N. S.) 143, stated:

> "A composition is a bargain between the bankrupt and his creditors which the court compels dissentients to accept. *In re Kline* (C. C. A. 2nd Cir.), 22 F. (2d) 906, 11 A. B. R. (N. S.) 156. The obligations are to be determined from the language used, as in any other contract."

In the case of *Seedman v. Friedman* (1942, 2nd Cir.), 132 F. 2d 290 at 294, 51 A. B. R. (N. S.) 63, there was a question as to an apparent conflict between a plan of arrangement and the Court's order confirming it. While

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[13]*Matter of Pollak Co.* (1936, 2nd Cir.), 86 F. 2d 99, 32 A. B. R. (N. S.) 409.

the Court ultimately construed the order as not being in conflict with the plan, it stated:

> "If there is a conflict between the terms of the arrangement and the confirmation order, there is a serious question as to the validity of the latter in view of the language of the statute, § 368, that the court shall retain jurisdiction 'if so provided in the arrangement'. Professor Moore says that the court has no discretion as to such retention and quotes a House Committee report on a forerunner of the Chandler Act to the effect that the wishes of the creditors should bind the court. 8 Collier on Bankruptcy, 14 Ed. (1941) 1244. . . ."

In the instant case, the creditors' consents to the plan were expressly conditioned upon the terms of the plan itself, which contained an express reservation of jurisdiction in the Bankruptcy Court to determine controversies such as that presented by the receiver's petition to subordinate the claim of the Bank. The construction placed upon the confirmation order by the Bank (and apparently adopted by the District Court and the Referee) is, however, in conflict with the plan and, therefore, in derogation of substantial contract rights of the consenting creditors. No notice having been given to the creditors as to any proposed changes in the plan and no creditors having modified their consents to the plan, the Referee's ruling that the order of confirmation modified the plan amounts to a deprivation of valuable property rights of the consenting creditors without due process of law.

The due process of law required in this situation is clearly set forth in the Bankruptcy Act. Section 364 thereof[14] provides that any alteration or modification of

[14] 11 U. S. C., Sec. 764.

a plan of arrangement which materially and adversely affects the interest of any creditors who have not in writing assented to the alteration or modification must, prior to confirmation, be submitted to the creditors for their acceptance and the Court must adjourn or reopen the creditors' meetings for that purpose. No such procedure was followed in this case and, therefore, there can be no valid contention that the order of confirmation had the effect of modifying the plan.[15]

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[15]It is significant to note that there is no authority given to the Bankruptcy Court in Chapter XI to modify the confirmed plan of arrangement. The significance of this omission becomes apparent by comparing the provisions to the similar provisions under Chapter X in which the Court is expressly authorized to alter or modify a plan, either before or after confirmation (Sec. 222, 11 U. S. C., Sec. 622); but even under Chapter X, the alteration or modification must be submitted for the approval of creditors and stockholders where the Court is of the opinion that their interests will be materially and adversely affected.

The Supreme Court has ruled in a Chapter X proceeding that a redistribution among the claimants of an unwarranted profit received by certain of the claimants subsequent to confirmation of the plan of reorganization did not materially and adversely affect the interests of the claimants under the confirmed plan and thus, that the reorganization Court had jurisdiction to order the claimants who had received such profits to pay the amount thereof over to the trustee for the benefit of all of the other claimants. In *Young v. Higbee Co.* (1945), 324 U. S. 204, 65 S. Ct. 594, 89 L. Ed. 890, 57 A. B. R. (N. S.) 730, the Court relied on Section 222 of the Act as giving the Court this jurisdiction, even after confirmation (Footnote 14 to the Court's opinion). The Court stated:

> "It is argued that even though the money paid in excess of the stock value does in equity and good conscience belong to the stockholders, the bankruptcy court is without power to award the relief prayed. Courts of bankruptcy are courts of equity and exercise all equitable powers unless prohibited by the Bankruptcy Act. [Citing cases.] The District Court still has jurisdiction to exercise its powers under the Act both because of its express reservation and because of the provisions of Section 222, 11 U. S. C. A., §622. That power is ample to authorize the court to order an accounting for the funds in dispute here. [Citing cases.]"

In urging that the Bankruptcy Court had no jurisdiction to entertain the receiver's petition, the Bank, both before the Referee and the District Court, seemed to place great reliance on Sections 367 and 368 of the Bankruptcy Act.[16]

Section 367 sets forth the procedure to be followed upon confirmation of an arrangement; the last subdivision of that section reads:

> "Except as otherwise provided in sections 369 and 370 of this Act, the case shall be dismissed."

Section 368 reads:

> "The court shall retain jurisdiction, *if so provided in the arrangement.*" (Emphasis added.)

It is clear from these provisions of the statute that it is the plan of arrangement that determines the scope of the reserved jurisdiction and not the order confirming it.[17]

It has, however, already been demonstrated herein that the plan of arrangement and the order of confirmation are replete with express reservations of jurisdiction in the Bankruptcy Court to hear and determine the matters set forth in the receiver's petitions.

Before the District Court the Bank placed considerable reliance upon the case of *Prudence Realization Corp. v.*

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[16]11 U. S. C., Secs. 767, 768.

[17]In its brief before the District Court the Bank asserted:

> "It is clear that under these provisions of the statute we must look to the order confirming the second amended plan of arrangement to determine what jurisdiction was reserved by the Court at that time." (Page 7 of Bank's *Reply Memorandum of Authorities* filed with the District Court.)

This position is the exact opposite of the statutory provision.

Ferris (1945), 323 U. S. 650, 89 L. Ed. 528, 65 S. Ct. 539. Analysis of the Supreme Court's opinion in that case, however, demonstrates that it supports the appellant's position herein and not the appellee's.[18]

The principal problem presented to the Supreme Court in *Prudence Realization Corp. v. Ferris* was to distinguish the earlier case of *Prudence Realization Corp. v. Geist* (1942), 316 U. S. 89, 86 L. Ed. 1293, 62 S. Ct. 978, which arose out of a related corporate reorganization. Both the *Geist* and *Ferris* cases involved the problem of whether the reorganization court had jurisdiction to hear and determine the question of whether certain security holders of the reorganized corporation should be subordinated in claim position to other security holders. In the *Geist* case, the Supreme Court held that the reorganization court had jurisdiction and in the *Ferris* case it held that it did not. The distinction is well stated by the Supreme Court

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[18]This case as well as *Prudence Realization Corp. v. Geist* (1942), 316 U. S. 89, 86 L. Ed. 1293, 62 S. Ct. 978, involve a corporate reorganization proceeding under Section 77(b) of the earlier Bankruptcy Act. Reorganization proceedings are considerably different from proceedings for an arrangement under Chapter XI of the present Bankruptcy Act. The corporate reorganization provisions are now included in Chapter X of the Bankruptcy Act (11 U. S. C., Secs. 501-676). An examination of Chapter X will reveal that there is no provision therein similar to Section 368 of the present Act which is quoted in the text, providing that the Court shall retain jurisdiction if so provided in the arrangement. The only provision in Chapter X which is remotely similar to Section 358 is Section 266 (11 U. S. C., Sec. 626) which makes provision for the transfer by the bankruptcy administrator to the reorganized debtor free and clear of all claims "except such claims and interests as may otherwise be provided for in the plan *or in the order confirming the plan* . . ." (Emphasis added.) Conceivably by reason of this section and the specific mention of the plan and the order, it could be argued under Chapter X there might be a variance between the reservation of jurisdiction contained in the plan and the order of confirmation. This is clearly not possible under Chapter XI.

in the *Ferris* case for it is pointed out that in the *Geist* case, jurisdiction was expressly reserved in the reorganization court to determine the question, whereas in the *Ferris* case, the reorganization court expressly refused to retain jurisdiction and provided that the parity question should be determined by a "court of competent jurisdiction." As stated by the Supreme Court, "In short, while the provisions for adjudication of the parity question in the *Geist* case clearly contemplated the determination of it as part of the reorganization proceedings by the Bankruptcy Court itself, in the present case, the Bankruptcy Court washed its hands of the problem and left the parties to litigate the question in another forum."[19] Our case is like the *Geist* case and under the provisions of the confirmed plan of arrangement, it was definitely contemplated that all questions pertaining to the claims, any subordination of claims or the classification of claims should be a part of the proceedings to be conducted by the Bankruptcy Court itself.

Another element of the *Ferris* case that is significant is that the Bankruptcy Court had entered a final decree discharging the trustees and closing the case. It is clear that there is a great deal of difference in the Bankruptcy Court's jurisdiction during the period after confirmation

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[19]The case of *In re East Boston Coal Co.* (D. C., Penna., 1942), 47 Fed. Supp. 593, 51 A. B. R. (N. S.) 626, which was relied upon by the Bank below, presented a question identical to that before the Supreme Court in the *Ferris* case. This case, too, was a reorganization proceeding and not a proceeding for an arrangement with creditors. The confirmed plan of reorganization expressly provided that it should not in any way alter the legal status of the debtor's lessee. Thus, when the lessee petitioned the reorganization Court for reformation of the lease, the Court ruled that this was a matter entirely foreign to the plan of reorganization over which the Court had no jurisdiction.

of a plan of arrangement and the jurisdiction the Court might have after a final order discharging the receiver and closing the estate. This difference is recognized in the statute itself,[20] the reasons for which are self-evident. Upon confirmation of a plan of arrangement, the Court has in its possession the consideration which has been deposited by the debtor which the Court must administer pursuant to the plan. It has whatever jurisdiction might be necessary to supervise the distribution of the funds *in custodia legis*. After the plan has been consummated and the consideration distributed, there is nothing further for the Court to do and, thus, a final decree is entered discharging the receiver and closing the estate.[21] Thus, prior to the final decree, the plan is executory and the Court has jurisdiction to carry out the plan, but after it has been fully executed there is nothing further to be done.

The only case cited by the Bank in the lower court that involved a Chapter XI proceeding was *Matter of Gordon* (D. C. N. Y. 1942), 44 Fed. Supp. 581, 51 A. B. R. (N. S.) 83, affirmed *per curiam* (1942, 2nd Cir.), 131 F. 2d 863. In that case the debtor, who was permitted to con-

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[20]Sections 369 and 372 of the Bankruptcy Act (11 U. S. C., Secs. 769, 772).

[21]This was the situation in *In Matter of Wedgewood Hotel Co.* (1942, 7th Cir.), 125 F. 2d 482, 48 A. B. R. (N. S.) 482, which was cited by the Bank to the Court below. The jurisdiction of the reorganization Court was invoked subsequent to the entry of the final order discharging the debtor and the trustee. The Court held that there was no jurisdiction after the final order. The distinction between this situation and the jurisdiction of the reorganization Court after confirmation but before the final order has been noted by the Court of Appeals for the 7th Circuit. *Matter of Hermitage Building Corp.* (1938), 100 F. 2d 597, 38 A. B. R. (N. S.) 667; *Matter of 4145 Broadway Hotel Co.* (1942), 131 F. 2d 120, 51 A. B. R. (N. S.) 162.

tinue the operation of his business under a confirmed plan of arrangement, defaulted in his obligations under the arrangement. The plan, as confirmed, made an express provision that upon such a default, title to all of the debtor's assets was to vest in a disbursing agent named by the Court. The debtor sought a change in the distribution of the assets from that set forth in the plan of arrangement and the Court quite properly held that inasmuch as no jurisdiction was reserved, there was no jurisdiction in the Court to entertain the application of the debtor to reopen the proceedings so as to alter the plan. Clearly, such is not our case. Here there was an express reservation of jurisdiction to hear and determine any and all controversies and classifications with respect to any claim that had been filed against the debtor.

(c) Under the Bankruptcy Court's Inherent Jurisdiction Over the Distribution of the Funds or Other Assets in Its Possession.

Quite apart from the provisions of the plan of arrangement and the order of confirmation, which, as has been shown, expressly reserved jurisdiction in the Court to grant the relief sought by the receiver in his petition, the Bankruptcy Court has exclusive jurisdiction over the distribution of the funds deposited with it by the debtor pursuant to the plan.

Under Section 337 of the Bankruptcy Act[22] it is provided that the debtor shall deposit the consideration to be distributed to the creditors "subject to the order of the court." Again, Section 369 of the Act[23] provides that the

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[22]11 U. S. C., Sec. 737.

[23]11 U. S. C., Sec. 769.

"court shall *in any event* retain jurisdiction until the final allowance or disallowance of all debts, affected by the arrangement . . . which . . . have been proved, but not allowed or disallowed, . . . or . . . are disputed or unliquidated. . . ." This reservation with respect to any unallowed or disputed or unliquidated claims is, of course, independent of any express reservation in the plan. Professor Collier has stated that the Court has jurisdiction "over the distribution of the money deposited by the debtor for priority debts and for the costs and expenses, and over the distribution of the consideration, if any, deposited by the debtor for creditors. That money and consideration are deposited 'subject to the order of the court' and are distributed 'subject to the control of the court.' "[24] In our case, the consideration of $500,000.00 paid into the Bankruptcy Court under the plan of arrangement constituted the *res* to which the proceedings pertained and over which the Bankruptcy Court has exclusive jurisdiction.

In Matter of Pollak Co., Inc. (1936, 2nd Cir.), 86 F. 2d 99, 32 A. B. R. (N. S.) 409, the Court described a controversy between a trustee and a creditor with respect to their respective rights to the consideration which had been deposited under a confirmed plan of arrangement as follows:

> "It relates only to distribution of the composition deposited, as to which the court retains jurisdiction, so long as any of the deposit remains undistributed."

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[24]8 Collier on Bankruptcy (14th Ed.), 1241.

In the case of *In re Hunter Hotel Enterprises* (D. C. N. Y., 1941), 44 Fed. Supp. 614 at 616, the Court stated after referring to Section 369 of the Bankruptcy Act:

> "This section clearly empowers the court to determine controversies with respect to claims which have not been finally settled at the date of confirmation where there is a fund available out of which a favorable judgment might be satisfied."

Section 312 of the Bankruptcy Act[25] provides that in proceedings under Chapter XI the jurisdiction, powers and duties of the Bankruptcy Court shall be the same as the Court would have in an ordinary bankruptcy proceeding immediately following an adjudication in bankruptcy, where not otherwise inconsistent with the provisions of Chapter XI. Of course in this case resort need not be had to that section of the statute by reason of the express inclusion in the plan of the reservation of jurisdiction to the same extent as if the debtor had been adjudicated a bankrupt with the receiver having been elected trustee in bankruptcy. The section is merely mentioned herein to demonstrate that even without such express reservation the Court would have had jurisdiction to hear and determine the receiver's petitions.

A very recent decision of the Supreme Court gives clear recognition to this fundamental aspect of the jurisdiction of the Court in a Chapter XI proceeding. Thus in *Manu-*

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[25]11 U. S. C., Sec. 712.

facturers Trust Company v. Becker et al. (1949), 338 U. S. 304, 94 L. Ed. 99 and 70 S. Ct. 127, which was a Chapter XI proceeding in which the trustee sought to subordinate the claims of certain creditors of the corporation to the claims of all the other creditors. This controversy between the trustee and the claimants whose claims he sought to subordinate arose after confirmation of the plan. Although the Supreme Court ruled that on the evidence in the record there was not a sufficient basis to subordinate the claims, there was implicit in its ruling a recognition that the Bankruptcy Court had jurisdiction to hear and determine the trustee's petition to subordinate. The Court stated:

> "Since the power of disallowance of claims, conferred on the bankruptcy court by §2 of the Act, 30 Stat. 545, 11 U. S. C. Sec. 11, embraces the rejection of claims 'in whole or in part, according to the equities of the case' (*Pepper v. Litton,* 308 U. S. 295, 304-305 (1939)), the court may undoubtedly require limitation of the amount of claims in view of equitable considerations. . . ."[26]

In that case there was a full hearing on the trustee's petition to subordinate and the ruling was on the basis of the evidence. In our case the lower court gave no opportunity to hear the equitable considerations for the reason that it ruled that it was without jurisdiction to entertain the petition.

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[26]338 U. S. 304, at 309, Footnote 7.

II.

The Receiver, Both Under the Plan and Under the Order Confirming It, Had the Right, Power, Authority and Duty to Present the Facts Set Forth in His Petition to the Bankruptcy Court, and to Invoke the Equitable Jurisdiction of the Court to Defer Any Payment of Dividends to the Bank of America Until the Claims of All Other Creditors Had Been Paid.

This point is but a corollary to the first point made herein as to the jurisdiction of the Court. It is made separately only for the reason that the Bank of America made a separate objection on this ground.[27]

By reason of the identity of this point to the first point made herein, all of the argument made under Point I is equally applicable here. Suffice it to say that under the plan the receiver was expressly given all the authority that a trustee in bankruptcy might have had. Although the Bank has repeatedly conceded that a trustee in bankruptcy would have such authority, it argues that the receiver in this case does not have such authority.[28] Here again the

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[27]The referee indicated that the lack of jurisdiction objection was the same as the objection made by the bank to the effect that the receiver was without authority to obtain the type of relief sought in his petition for subordination [Tr. 160].

[28]In its brief before the District Court, the Bank stated:

> "Counsel for the Receiver argues quite strenuously . . . that the Bankruptcy Court and a Trustee in Bankruptcy have the power and jurisdiction to subordinate the payment of dividends on claims as between creditors of the same class. We have no quarrel with these authorities. As counsel has pointed out, we conceded before the Referee that a Bankruptcy Court has the general power and jurisdiction in a pending bankruptcy proceeding to adjudicate such controversies. Our point is that *in this proceeding* and under the order of confirmation entered by the referee, jurisdiction to determine such contro-

Bank points to the order of confirmation as somehow limiting the authority, but our position with respect to that contention has already been set forth herein.

The following are but a few of the numerous cases recognizing the authority of a trustee in bankruptcy to bring appropriate proceedings before the Bankruptcy Court to determine whether the claims of certain creditors should be subordinated to other creditors of the same class.

Pepper v. Litton, 308 U. S. 295, 41 Am. B. R. (N. S.) 279, 84 L. Ed. 281, 60 S. Ct. 238;

American Surety Co. v. Sampsell (1946), 327 U. S. 269, 90 L. Ed. 663, 66 S. Ct. 571;

Goldie v. Cox (1942, 8th Cir.), 130 F. 2d 695, 50 A. B. R. (N. S.) 560;

In re Loewer's Gambrinus Brewery Co. (1948, 2nd Cir.), 167 F. 2d 318;

Bank of America National Trust & Savings Association v. Erickson (1941, 9th Cir.), 117 F. 2d 796, 45 A. B. R. (N. S.) 503.

The authority of the Bankruptcy Court's administrator to initiate such proceedings is expressly provided in Section 341 of the Act[29] wherein it gives him all of the powers and duties that a trustee in bankruptcy would have after the entry of an order of adjudication in an ordinary bankruptcy proceeding, which authority was expressly con-

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versies has not been reserved, and under the statute and decisions the Court's general equity powers and general bankruptcy powers have been limited to the jurisdiction reserved by the order confirming the plan."

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[29]11 U. S. C., Sec. 741.

ferred on the receiver in this case by the confirmed plan of arrangement.

There is a similar authorization to the Bankruptcy Court's officers in all of the other types of proceedings covered by the Bankruptcy Act.[30]

The Bank has strenuously urged that the case of *Wallace v. Ohio Valley Bank* (1924, 4th Cir.), 2 F. 2d 53, 4 A. B. R. (N. S.) 594, supports its position. We respectfully submit, however, that the case supports the position of the appellant herein. In that case the facts involved and the ruling are stated by the Court as follows:

> "Another of the trustee's exceptions goes to the entire claim of the bank. It alleges that the bank for the purpose of getting undeserved credit for the bankrupt knowingly made false statements as to the latter's financial condition and that those to whom they were made acted upon them and suffered thereby. The trustee argues that in consequence the bank is not entitled to receive anything from the bankrupt estate until after its other creditors have been paid in full. To sustain this exception the trustee relies upon the telegram and the letter sent by the bank to Greenbaum and, as we understand the record, upon them alone. If they made the bank liable to anyone

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[30]Chapter VIII, Agricultural Compositions and Extensions, Section 75(m) (11 U. S. C., Sec. 203(m));

Railroad Reorganization, Section 77(c)(2) (11 U. S. C., Sec. 205(c)(2));

Chapter X, Corporate Reorganization, Section 114 (11 U. S. C., Sec. 514);

Chapter XI, Real Property Arrangements, Section 441 (11 U. S. C., Sec. 841);

Chapter XIII, Wage Earners' Plan, Section 636 (11 U. S. C., Sec. 1036).

as to which we intimate no opinion whatever, it was to Greenbaum. If anyone was deceived by them, it was Greenbaum and it alone suffered from them. The money the bankrupt obtained from it went to swell the bankrupt's resources and to a greater or less extent benefited the bankrupt's other creditors. As representing them, the trustee has not been hurt. Doubtless a case can be conceived in which a creditor of a debtor in failing circumstances may for its own purposes seek by knowingly false statements to obtain credit for the debtor from any or from all who may deal with the latter. Under such conditions it may be that the trustee as representing the creditors generally has the right to insist that in the distribution of the bankrupt's estate, the improper action of the one creditor shall estop it from competing with its victims, but such rule of law, if it exists, has no application to the instant case. The learned court below was right in overruling this exception."

It is apparent from a reading of the above quoted portion of the opinion that the Court recognized that the trustee would have authority to bring the controversy to the court's attention for determination. The Court affirmed the ruling against the trustee because the trustee had failed to prove that the alleged inequitable conduct of the bank affected any more than one creditor, but recognized the possibility of the trustee's successfully subordinating the claim of the bank if he could show that the course of conduct affected all of the unpaid creditors of the bankrupt. The doubts expressed by the Court as to

the right to subordinate a claim under such circumstances whereby all of the creditors were affected have now been removed by the line of Supreme Court decisions commencing with *Pepper v. Litton.* The Court of Appeals for the Third Circuit has recently had occasion to make the following observation on the current trend of decisions broadening the scope of the jurisdiction of the Bankruptcy Court:

> "The tendency of judicial interpretation of the Act has been in the direction of progressive liberalization in respect of the operation of the bankruptcy power so as to meet the challenge of present day economic and business conditions. *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.,* 1935, 294 U. S. 648, 675, 676, 55 S. Ct. 595, 79 L. Ed. 1110. Among the powers granted under the Act are *the collection and distribution of the estates of bankrupts and the determination of controversies in relation thereto.* The bankruptcy court may invoke its equitable powers to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done. By reason of the express provisions of Sec. 2 and Sec. 57, sub. k, these powers are to be exercised in the allowance, disallowance or subordination of claims according to the equities of the case. *Pepper v. Litton,* 1939, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281."
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> (*In re International Power Securities Corporation* (1948), 170 F. 2d 399 at 402.)

In our case, it was alleged in the supplement to the original petition that "the current unpaid trade creditors in the within reorganization proceedings extended credit to the debtor substantially in reliance upon the position taken by the Bank of America and the misinformation circulated by it in connection with the financial condition of the debtor and the purported financial support thereof by Northrop Aircraft, Inc.; that the Bank of America well knew that the said creditors would so rely upon the facts as alleged hereinabove in extending credit to the debtor herein" [Tr. 65]. A similar allegation is contained in the amended petition of the trustee [Tr. 104].

By reason of the ruling of the Referee and District Court below, the receiver has never had an opportunity to prove those allegations. Of course, if he fails in his proof and is able to show that only one or two creditors were misled by the Bank's conduct, his attempt to subordinate the claim of the Bank may be unsuccessful as to other creditors. In asking this Court to reverse the rulings below, the receiver is merely asking to be afforded his day in court.

The Bank has also relied on *In re Railroad Supply Co.* (1935, 7th Cir.), 78 F. 2d 530, 29 A. B. R. (N. S.) 444, but that case is not in point because it involved the attempt of one creditor in a bankruptcy proceeding to subordinate the claim of another creditor. The Bank should be well aware of this distinction because this Court has already had occasion to indicate its view to the Bank with respect to the applicability of the *Railroad Supply* case to a

situation where the evidence showed that all of the creditors had been affected by the conduct complained of. In *Bank of America v. Erickson* (1941, 9th Cir.), 117 F. 2d 796, 45 A. B. R. (N. S.) 503, this Court stated:

> ". . . Appellant cites *In re Railroad Supply Co.* (C. C. A., 7th Cir.), 29 Am. B. R. (N. S.) 444, 78 F. (2d) 530, as supporting its contention. There the court declined to defer distribution pending disposition of a dispute between two creditors whose controversy was of no concern to other creditors or to the estate. The Circuit Court of Appeals affirmed, believing the course discretionary and holding that the discretion had not been abused. The decision obviously does not support appellant. The present agreement affects all creditors, and a determination in bankruptcy of the rights fixed by it is essential to an orderly administration of the estate."[31]

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[31]The other cases that were relied upon by the Bank before the Referee and the District Court involve identical situations with identical holdings. (*Ingram v. Lehr* (1930, 9th Cir.), 41 F. 2d 169, 16 A. B. R. (N. S.) 215; *Matter of Bowman Hardware & Electric Co.* (1933, 7th Cir.), 67 F. 2d 792, 24 A. B. R. (N. S.) 405.) In each case the respective court ruled that the trustee did not prevail because he was able to show that the conduct complained of misled only one creditor of the estate. The Bank also cited *Moore v. Bay* (1931), 284 U. S. 4, 76 L. Ed. 133, but did not make clear just how the rule of that case has any application to the instant case; appellant has no quarrel with the rule of *Moore v. Bay* and does not attempt, in support of his position, either to apply it or to avoid it.

III.

The Facts Set Forth in Petition and Supplement Thereto, or in the Amended Petition, if Proved, Would Entitle the Receiver to the Relief Prayed For.

The authorities discussed and referred to in the preceding portions of this brief, establish the rule that a Bankruptcy Court has jurisdiction, upon a proper showing, to subordinate the payment of the claims of one creditor to those of other creditors of the same class where such subordination will further the ends of justice and equity. While the Referee orally expressly refused to hold that the pleadings of the receiver did not state facts sufficient to entitle him to the relief prayed for [Tr. 159-160], the Referee's written order [Tr. 83], and the order of the District Court affirming the Referee [Tr. 150] are subject to the interpretation that the pleadings of the receiver were substantially deficient, because both orders contain a recital that all the objections set forth in the Bank's response are well founded.

We strenuously urge that in this respect the District Court and the Referee erred, which error was compounded by the refusal to grant the receiver permission to amend his pleadings. While the pleadings were lengthy, their import can be summarized as follows [Tr. 58-66]:

> The Bank of America was thoroughly familiar with the many financial reports regularly submitted to it by the debtor. These reports showed that for a considerable period of time prior to the commencement of the Chapter XI proceedings, the debtor was insolvent and was in default under its loan agreement with the Bank. During this period, the Bank

was aware of the fact that the debtor was giving the Bank as a credit reference to all persons making credit inquiries of the debtor and that in response to such inquiries, the Bank, despite the aforesaid knowledge of the unsound financial condition of the debtor, gave information to all who inquired that the debtor was in sound financial condition and that it was a wholly-owned subsidiary of Northrop Aircraft and indicated that Northrop would pay the debts of Salsbury, the debtor herein. The Bank gave similar information to credit agencies, which information the Bank knew would be included in financial reports distributed by those agencies and which reports would be used by persons in determining whether or not to extend credit to the debtor.[32] The persons who are now the existing unsecured trade creditors of the debtor, relied upon this misinformation furnished by the Bank in determining to extend credit to the debtor. At all times referred to in the pleadings, the

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[32]This Court has recently had occasion to comment on the purpose of such credit reference reports in *Yates v. Boteler* (1947, 9th Cir.), 163 F. 2d 953, in which it was held that the giving of false financial information to Dun & Bradstreet was a sufficient basis to deny a discharge in bankruptcy. The Court observed, "The appellant is described by his counsel as being an unlearned man, unversed in the devious ways of accountancy. But we doubt that any practical businessman of the present day could be so naive as to be unaware of the purpose for which credit agencies are established." (163 F. 2d at 956.)

The receiver's amended petition contained a positive allegation that the Bank had given false information pertaining to the debtor to Dun & Bradstreet [Tr. 99].

Bank knew that the debtor was insolvent and was in default under its loan agreement with the Bank.[33]

The foregoing summary of the pleadings relates only to the original pleadings. The amended petition of the receiver was not ruled upon by the Referee and, apparently, was not ruled upon by the District Court because the Referee indicated that he would not consider the amended petition in connection with his ruling, having expressly refused to give the receiver leave to file it [Tr. 165-166]. The amended petition contained a more complete statement of facts upon which the receiver relied in support of his prayer to subordinate the claim of the Bank [Tr. 92-107].

No purpose would be served by repeating in this portion of the brief the references to the numerous cases recognizing the power and duty of the Bankruptcy Court to grant such relief when the circumstances warrant it. A few of the cases on this point are collected in the foot-

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[33]The pleadings contained separate and alternative allegations concerning subordination of the Bank's claim with respect to the $75,000.00 paid to the receiver by Northrop in settlement of the receiver's objections to Northrop's claim [Tr. 60-61]. Subsequently, however, the Bank obtained from Northrop an amount equal to the amount that the Bank would have received from the Northrop dividend [Tr. 76-78]. The exact amount of the payment does not appear in the record but an estimate is made in the original indemnity agreement in the sum of approximately $90,000.00 [Tr. 69]. By reason of this payment, the Bank has released the receiver from any liability with respect to any dividends from the Northrop claim unless additional assets are recovered by the receiver [Tr. 78].

note.[34] For the convenience of the Court we have included as an appendix to this brief, references to the leading bankruptcy texts dealing with this subject.

One of the cases which is of particular significance is *Columbia Gas & Electric Corporation v. United States, et al.* (1945, 6th Cir.), 151 F. 2d 461, rehearing denied 135 F. 2d 101, *Cert. den.* 329 U. S. 737. That case involved a Chapter X proceeding in which the trustee had successfully objected to the claim of Columbia Gas & Electric Corporation. The basis for the objection was that Columbia Gas & Electric had acquired its claim against the debtor as a part of a scheme in violation of the Anti-Trust Laws to obtain a monopoly in the field in which the debtor had been engaged. The Court of Appeals modified the holding by providing that the claim should not be disallowed but should be subordinated to the claims of all

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[34] *In re Headley* (1899, D. C., Mo.), 97 Fed. 765, 3 A. B. R. 272;

In re Royce Dry Goods (1904, D. C., Mo.), 133 Fed. 100, 13 A. B. R. 257;

Carter v. Bogden (1926, 8th Cir.), 13 F. 2d 90, 8 A. B. R. (N. S.) 247;

Bird & Sons v. Tobin (1935, 8th Cir.), 78 F. 2d 371, 100 A. L. R. 654, 29 A. B. R. (N. S.) 171;

Pepper v. Litton (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 A. B. R. (N. S.) 279;

Bank of America v. Erickson (1941, 9th Cir.), 117 F. 2d 796, 45 A. B. R. (N. S.) 503;

Goldie v. Cox (1942, 8th Cir.), 130 F. 2d 695, 50 A. B. R. (N. S.) 560;

Prudence Realization Corp. v. Geist (1942), 316 U. S. 89, 86 L. Ed. 1293, 62 S. Ct. 978;

Columbia Gas & Electric Corp. v. U. S. (1945, 6th Cir.), 151 F. 2d 461; rehearing denied, 153 F. 2d 101; *Cert. den.*, 329 U. S. 737;

In re Loewer's Gambrinus Brewery Co. (1948, 2nd Cir.), 167 F. 2d 318.

other creditors by reason of the conduct of the claimant which was found to be detrimental and prejudicial to the debtor and all of the creditors thereof. In denying a rehearing, the Court of Appeals stated:

> "We have given careful consideration to the petition and the argument for modification contained therein. (1) We have noted the observation in *Prudence Realization Corp. v. Geist, supra,* wherein the Supreme Court, in referring to the Court of Appeals decision therein, said [316 U. S. 89, 62 S. Ct. 981]: 'It recognized also that the equity powers of the bankruptcy court may be exerted to subordinate the claims of one claimant to those of others of the same class where his conduct in acquiring or asserting his claim is contrary to established equitable principles.' Putting aside the question whether the recited observation bore upon decision, in view of the specific facts of the Prudence case, we find ourselves unable to construe it as a limitation upon the equity powers of the court to subordinate claims acquired in pursuit of illegal or inequitable conduct to those of creditors of a single class where it has been made clear, as in the present case, that the inevitable result of established illegal or inequitable conduct has irrevocably impaired the interests of creditors of every class, however difficult it may be at a later date to measure such impairment." (153 F. 2d 101-102.)[35]

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[35]The only case cited by the Bank as being contrary to this fundamental equitable principle is *Crowder v. Allan West Commission Co.* (1913, 8th Cir.), 213 Fed. 177, 32 A. B. R. 134. Whether or not the age of the case renders it of doubtful authority today in the light of the recent trends, it is clearly distinguishable from our case. There the Court of Appeals affirmed the trial court's refusal to subordinate the claim of a creditor be-

Conclusion.

The ruling of the Referee and the District Court places the conduct of the Bank as set forth in the receiver's pleadings beyond the reach of the Bankruptcy Court. The authorities hereinabove referred to would require, upon proof of the conduct complained of, that the claim of the Bank be subordinated to the claims of all other creditors. The record in this case reveals that even if the Bank's claim were to be subordinated to the claims of all other creditors, the Bank would still fare better with respect to its *pro rata* recovery from the debtor's estate than all of the other creditors whom the receiver has alleged were misled by the conduct of the Bank. The Bank's claim, as filed in this proceeding, was filed as a partially secured debt [Tr. 124-128]. The security consisted of a deed of trust on the real estate owned by the debtor [Tr. 135-147]. The face of the claim shows, however, that the security was given to secure an indebtedness evidenced by a promissory note in the sum of $180,000.00 [Tr. 125, 127-129], but the Bank was able to take advantage of the provision in the deed of trust that it was given to secure any future advances that might have been made by the Bank to the debtor [Tr. 125, 137]. Although the printed record before this Court does not make it apparent, in the original deed of trust this catch-all clause was buried

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cause there was no showing that the creditor had given false information to other creditors. There was merely an omission to give information to creditors as to all of the facts within the knowledge of the creditor whose claim the trustee sought to subordinate. In our case, it is alleged that the Bank knowingly gave false and misleading information. If these allegations are proved, the receiver would be entitled to the relief requested and there is nothing in the *Crowder* case in any way contrary thereto.

in a mass of small print, along with the more usual provisions of the normal type of deed of trust.

The Bank asserted that the value of the security at the time of the commencement of the bankruptcy proceedings was in excess of $300,000.00 [Tr. 126], on which the Bank asserted its rights, notwithstanding the fact that the note it was given to secure had been paid down to $159,300.00 [Tr. 129]. The Bank was able to obtain from Northrop Aircraft, the parent corporation of the debtor in these proceedings, approximately $90,000.00 [Tr. 76-78], although the receiver had alleged that the Bank was the one creditor that had actual knowledge that Northrop was not guaranteeing the indebtedness of the debtor; the Bank had exacted from Northrop an agreement to subordinate payment of all of Northrop's claims against the debtor, to the claims of the Bank of America [Tr. 61]. The Bank was further able to better its position by reason of the attempted exercise of an alleged banker's lien and offset by means of which the Bank seized commercial paper and merchandise of a value of approximately $175,000.00 [Tr. 126].[36]

It clearly appears from these facts that the Bank will succeed in its efforts to realize 100 cents on the dollar on all of the indebtedness owing from the debtor to the Bank, either as the result of dividends received out of the bankruptcy proceeding or as the result of the assertion of an alleged moral obligation against the parent of the debtor to make the Bank whole [Tr. 103]. But the appellant is

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[36]This is the matter which is now pending before this Court in the proceedings numbered 12206 between the same parties as are involved in the instant appeal.

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The ruling of the Referee and the District Court places the conduct of the Bank as set forth in the receiver's pleadings beyond the reach of the Bankruptcy Court. The authorities hereinabove referred to would require, upon proof of the conduct complained of, that the claim of the Bank be subordinated to the claims of all other creditors. The record in this case reveals that even if the Bank's claim were to be subordinated to the claims of all other creditors, the Bank would still fare better with respect to its *pro rata* recovery from the debtor's estate than all of the other creditors whom the receiver has alleged were misled by the conduct of the Bank. The Bank's claim, as filed in this proceeding, was filed as a partially secured debt [Tr. 124-128]. The security consisted of a deed of trust on the real estate owned by the debtor [Tr. 135-147]. The face of the claim shows, however, that the security was given to secure an indebtedness evidenced by a promissory note in the sum of $180,000.00 [Tr. 125, 127-129], but the Bank was able to take advantage of the provision in the deed of trust that it was given to secure any future advances that might have been made by the Bank to the debtor [Tr. 125, 137]. Although the printed record before this Court does not make it apparent, in the original deed of trust this catch-all clause was buried

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[36]This is the matter which is now pending before this Court in the proceedings numbered 12206 between the same parties as are involved in the instant appeal.

not relying on these facts on this appeal. The appellant is merely asking, on behalf of all of the unsecured and unpaid creditors of the debtor, to have the opportunity to prove that the Bank was guilty of such conduct in its dealings with the other creditors of the debtor as to require, under the governing authorities, the subordination of the Bank's claim against the debtor to the claims of those creditors of the debtor who have suffered, and will suffer, by reason of false and misleading information given to them by the Bank.

The record in this case requires a reversal of the rulings below. The Bankruptcy Court clearly has jurisdiction to subordinate the claim of one creditor to the claim of all others upon proof of the facts alleged by the receiver in his petition for subordination. Appellant appears before this Court on this appeal on behalf of all of the creditors of the debtor, asking for his day in court, requesting merely that he be allowed the opportunity to prove the allegations of his petition and supplement thereto, which, for purposes of this appeal, are admitted. Appellant also urges that the ruling of this Court should include the authorization for the receiver to proceed on his amended petition,[37] which includes more complete allegations by reason of additional information acquired by the receiver through use of the discovery procedure provided by the Federal Rules of Civil Procedure.

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[37]Although the Bankruptcy Court expressly refused to consider or rule upon the amended petition, we respectfully urge this Court to pass upon the sufficiency of the amended petition. Only in this way will the trial court have the benefit of this Court's views on the amended petition in the event there is a reversal of the lower court's ruling and the case remanded for further proceedings.

If the rulings below are to be sustained, the necessary implication is that under the Bankruptcy Act, a creditor who has knowingly and wilfully given false information to other creditors, on the basis of which said other creditors extended credit to the bankrupt, can participate in the proceeds of the bankrupt's assets on an equal basis with the very creditors it misled. We do not believe that such conduct has suddenly become beyond the reach of the Bankruptcy Court.

Dated: This 26th day of June, 1950.

Respectfully submitted,

GENDEL & RASKOFF,
By H. MILES RASKOFF,
Attorneys for Appellant.

APPENDIX.

3 Collier on Bankruptcy, 14th Ed., §57d. The Judicial Act of Allowance, Disallowance, Postponement or Subordination; §2a(2).

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"Allowance and disallowance are judicial acts. Jurisdiction to allow and disallow is based on §2a(2); and the jurisdiction of the bankruptcy court in this respect is exclusive of all other courts. In passing on an allowance of claims the court sits as a court of equity, which gives it far-reaching powers 'to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate.' Mere reasons of equity may sometimes require that a creditor's claim be either totally disallowed or subordinated to the claims of all or of certain other general creditors, such as where the creditor is closely related to the bankrupt, or as a majority stockholder or corporate officer should be treated as a proprietor rather than as a creditor, or where by some previous conduct he is estopped to claim parity with other creditors." (p. 185.)

3 Collier on Bankruptcy, 14th Ed., Ch. 63.08. Subordination or Postponement of Claims.

"As mentioned in ¶¶63.06 and 63.07, *supra,* in connection with certain equitable defenses, a claim may be provable and on principle also allowable, and yet due to circumstances surrounding its origin it may appear unfair to allow the claim to compete with those of other creditors on a footing of equal-

ity. The claimant's conduct may have been the direct or indirect cause for other creditors to change their position, or may warrant the inference that his investment, though legally a credit, was economically more in the nature of a partnership or similar commercial venture more or less identifying the claimant with the bankrupt, or it may be tainted with some degree of fraud, deceit or other objectionable practice. Under these and comparable circumstances, the claimant should not, through a straight allowance, be permitted to increase the loss already suffered by other creditors while on the other hand the facts may not be sufficient to justify complete disallowance. The compromise as worked out by judicial practice is a mode of relative disallowance, the judge-made counterpart to the priorities provided by the Act, and is usually called 'postponement' or 'subordination.' It is one of the valuable contributions of equity to the body of statutory bankruptcy law." (pp. 1809-1810.)

6 Remington on Bankruptcy, 477. Postponing Dividends of Some Creditors to Others Because of Equities.

"§2875. Postponing Dividends of Some Creditors to Others Because of Equities. Under the power of the court to adjust the equities existing among general creditors, it has been held that the claims of creditors, who, though not guilty of preferences avoidable under the peculiar provisions of the Bank-

ruptcy Act have yet been guilty of conduct which, under the ordinary rules of equity, would make it inequitable for them to share in the dividends on an equality with other creditors, may be postponed to the claims of other creditors in the distribution of dividends." (p. 477.)

1947 Supplement to Volume 6, Remington on Bankruptcy, continuing on Section 2875, at page 138:

"Subordination is a means of regulating distribution results in bankruptcy by adjusting the order of creditors' payments to the equitable levels of their comparative claim positions. Its fundamental aim is to undo or to offset any inequity in the claim position of a creditor that will produce injustice or unfairness to other creditors in terms of bankruptcy results. Its most common uses are to nullify any fraud that a creditor has committed and to prevent unjust enrichment in a fiduciary relation."